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No. 80-702

IN THE

Supreme Court of the United States

October Term, 1980

UNITED STATES OF AMERICA, *Petitioner,*

v.

STATE OF NEW MEXICO, *et al., Respondents.*

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF OF THE STATE OF NEW MEXICO

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QUESTIONS PRESENTED

1. Whether three private corporate contractors performing contracts for the United States Atomic Energy Commission ("AEC") and its successors are subject to the New Mexico gross receipts and compensating taxes (§§72-16A-1, *et seq.*, N.M.S.A. 1953) on funds received under their contracts to pay salaries and related costs of their own employees, their own award fees, and obligations to third party suppliers from whom they have ordered in their own names.

2. Whether reliance by three private corporate contractors on an "advanced funding" arrangement pursuant to 41 U.S.C. §255, §4(c)(2) of the Atomic Energy Act of 1946, now codified at 42 U.S.C. §2061(b), and 31 C.F.R. Part 205 (1976) to finance their performance of contract work for the Atomic Energy Commission, renders such contractors federal agents exempt from the New Mexico gross receipts tax on such funds, where the funds are used to meet the contractors' obligations, not those of the federal government.

3. Whether, in the absence of Congressional authorization, agency-creating clauses inserted in contracts with three private corporate contractors performing work for the Atomic Energy Commission, insulate them from the New Mexico gross receipts and compensating taxes.

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BRIEF OF THE STATE OF NEW MEXICO

OPINIONS BELOW

The opinion of the district court (Pet. App. 1a-10a) is reported at 455 F.Supp. 993. The opinion of the court of appeals (Pet. App. 11a-28a) is reported at 624 F.2d 111.

JURISDICTION

The jurisdictional requisites are adequately set forth in the United States' Brief, 1.

STATUTES INVOLVED

Additional parts of New Mexico's Gross Receipts and Compensating Tax Act, N.M. Stat. Ann. 1953, §§72-16A-2, 72-16A-3K [(as amended) (1978 Supp.)], 72-16A-12.17 and 72-16A-14.9 [(as amended) (1978 Supp.)], are set forth in App. A, *infra.* Also set forth are 41 U.S.C. §255, §4(c)(2) of the Atomic Energy Act of 1946, codified at 42 U.S.C. §2061, and 31 C.F.R. Part 205 (1976), as Appendices B, C and D, *infra.*

STATEMENT OF THE CASE

This case raises the issue of why three "standard" private contractors working for the Atomic Energy Commission should be deemed "procurement agents," immune from the New Mexico gross receipts and compensating taxes, U.S. Brief, 3. It is conceded that the contractors, all subsidiaries of large corporations, do not meet the tests of a federal instrumentality, U.S. Brief, 2, 3; J.A. 201. It is conceded that the contractors "may be" independent contractors in "directing the details of day-to-day research . . . and the hiring and direct supervision of employees," J.A. 197. It is conceded that the contractors' 7,400 employees, whose salaries and related benefits account for 58% of the contractors' costs, are not employees of the federal government which disclaims liability for their torts, J.A. 200, R.IV, Interrogs. 36, 52, Aug. 31, Oct. 15, 1976. In dealing with third-party suppliers, the contractors are required to order in their own names, J.A. 36-37. Their purchase forms specifically identify them as the "Buyer," as distinguished from the government itself, J.A. 120.

The United States repeatedly stresses the "standard" content of the New Mexico contracts as evidence that the contractors

are tax-immune "procurement agents," U.S. Brief, 3, 15, 16, 17, 26-28, 39, 40. The underlying premise is refuted by the United States' own witness who agrees that "[t]he contract document is *not* a standard form except for the necessary boiler plate. It is tailored in general terms to the particular programs and relationships of the parties," R.VI, Carretta depo., 16, emphasis added. The "standard" contract feature on which the United States bases its entire case is the financing of the contractors' operations through an "advanced funding" arrangement by which the contractors draw funds from a federal reserve bank, pursuant to a letter of credit administered by the Treasury Department, to cover checks previously issued to their obligees, U.S. Brief, 4. The United States concedes that it is the *contractors* who pay their own employees and suppliers, *id.* The United States acknowledges that the advanced funding arrangement places funds at the *contractors'* disposal; it does not extend to the contractors' obligees, *id.*

Advanced funding has been used by AEC and its successors for some thirty years as an expedient method to "speed up reimbursement" of "cost-reimbursed operating contractors," J.A. 189, 204. It is widely used throughout the government; the AEC contractors number a mere one hundred and sixty-five out of 10,369 current recipients, R.VI, McGrath depo., 9.

On July 1, 1977, two years after this case commenced, the United States and the contractors entered into modifications which stated that each contractor "acts as an agent," J.A. 50, 55, 59, while disclaiming any intent to "formally and directly designat[e] the contractors as agents," J.A. 64. The modifications further state that they shall "not be construed" to "create rights or obligations not otherwise provided for in the contract," J.A. 52, 57, 61.

Sandia Corporation receives no fee for its work. However, its parent, Western Electric, receives royalty-free licenses from

Sandia's work, salary reimbursements totalling $312,000 in a sample year and additional payments for audit services and supervision, J.A. 35, 40-42; R.IV, Interrog. 40, Aug. 31, 1976. Western Electric also made over six billion dollars of profit-making sales to the United States between 1966 and 1975, R.IV, Interrog. 44, ex. 2, June 22, 1977.

The characterization of the New Mexico gross receipts tax as falling upon persons "engaged in the construction business or in performing services of a professional, technical, or scientific nature," U.S. Brief, 5, is not sufficiently descriptive. In pertinent part, the tax is upon the "privilege of engaging in business", §72-16A-4, N.M.S.A. 1953. "Engaging in business" means "carrying on or causing to be carried on any activity with the purpose of direct or indirect benefit", §72-16A-3(E). The tax is levied upon the "gross receipts" of a person engaging in business, defined as "the total amount of money or the value of other consideration, received from selling property in New Mexico . . . or from performing services in New Mexico . . .", §72-16A-3(F). The "compensating tax" is levied on the "privilege of using property in New Mexico" and, in pertinent part, is levied on property "acquired outside this state as the result of a transaction that would have been subject to the gross receipts tax had it occurred within this state", §72-16A-7.

Except for a limited number of exempted entities or transactions, the gross receipts tax falls on virtually everyone doing business in the state. As distinguished from many sales taxes, it falls on receipts both from selling goods and performing services, §72-16A-3(F). Thus, doctors, lawyers, consultants and contractors pay it, along with retailers and other merchants. As conceded by the United States, its statutory legal incidence falls on the vendor of goods and services, not the customer, U.S. Brief, 25. Thus, the fact that the United States is the customer of a contractor does not bar the tax on the contractor.

The United States characterizes *United States v. Bureau of Revenue*, 87 N.M. 164, 531 P.2d 212 (Ct.App. 1975), as concerning the gross receipts tax, the same tax at issue here, U.S. Brief, 6. In fact, that case concerned the Emergency School Tax, predecessor to the gross receipts tax, which was repealed in 1967. This error should be corrected since it bolsters the United States' later contention that it failed to modify its contracts before 1977 because "the State had previously recognized that the contractors were procurement agents", U.S. Brief, 41, n. 17.

SUMMARY OF ARGUMENT

In *James v. Dravo Contracting Company*, 302 U.S. 134 (1937), this Court upheld the application of a non-discriminatory state gross receipts tax to the receipts of a federal contractor. So long as the legal incidence of the tax fell on the contractor, the fact that the economic burden passed to the United States did not bar the tax. In the present case, the court of appeals upheld the application of just such a gross receipts tax as was approved in *James v. Dravo* to the receipts of three Atomic Energy Commission contractors performing under contracts in New Mexico.

The United States contends that the three contractors are immune from the New Mexico tax by virtue of being federal "procurement agents", based on *Kern-Limerick, Inc. v. Scurlock*, 347 U.S. 110 (1954). This case held that federal contractors were insulated from state sales taxes in their dealings with suppliers through contracts and purchase orders explicitly stating that "The Contractor shall act as the purchasing agent of the Government" and that "The Government shall be obligated to the Vendor for the purchase price", 347 U.S. at 113, n. 2, 119. The United States' dilemma in applying *Kern-Limerick* to the present case is that fifty-eight percent of the contractors' gross

receipts went to meet their own payrolls, employee benefit packages and internal costs, R.IV, Interrogs. 36, 52, Aug. 31 and Oct. 15, 1976, rather than obligations to suppliers. The United States concedes that the contractors' employees are not employees of the United States and denies any tort liability arising from their activities, J.A. 200. It further concedes that the contractors do not meet the tests of federal instrumentalities, J.A. 201, and "may be . . . 'independent contractor[s]', rather than . . . 'servant[s]' for . . . directing the details of day-to-day research or maintenance operations and the hiring and direct supervision of employees. . .", J.A. 197. Given these concessions, it is clear that the contractors do not function as "procurement agents" in dealing with their own employees and are taxable on the receipts reflecting these costs.

The remainder of the contractors' receipts relate to transactions with suppliers, but the contractors do not function as procurement agents. Their contracts and purchase orders are devoid of language designating them as agents or manifesting an equivalent intent, R.IV, Interrogs. 11, 12, Aug. 31, 1976, Feb. 7, 1977. To the contrary, the contract of Sandia, for example, requires that "All purchase orders, subcontracts and other commitments shall be made in the name of Sandia Corporation. . .", J.A. 36-37. Similarly, another contractor's purchase documents specify that the "Buyer" is "THE ZIA COMPANY in the performance of the prime contract W-17-028-ENG-90 with the United States of America and includes any duly authorized representative thereof", J.A. 120, emphasis in the original. The same documents separately define the "Government" to mean only "the United States of America", J.A. 120, differentiating it from the contractors who are the "Buyer[s]".

Conceding that "[t]he agency relationship in *Kern-Limerick* was express" while the purported relationship here must be "implied", R.III, Plaintiff's Opposition to Defendants' Cross Motion For Summary Judgment, 10, the United States hangs its entire case on the fact that the contractors are financed

through an "advanced funding" method. To relieve them of the need to secure private financing, the contractors are authorized to draw funds from a federal reserve bank, pursuant to a letter of credit system administered by the Treasury Department, to cover the checks they issue to obligees, U.S. Brief, 4-5.

The United States would presumably concede that not every contractor paid in advance is a federal procurement agent. Advanced funding is simply a method to "speed up reimbursement" of AEC's "cost-reimbursed operating contractors", J.A. 189, 204. Although their funds are advanced, the AEC contractors are required to submit an annual voucher which is subject to a "reimbursement audit" to "verify the contractors' net expenditures", J.A. 20, 191. Advanced funding is not unique to Atomic Energy Commission contractors which number a mere 165 out of the 10,369 current recipients, R.VI, McGrath depo., 9. The majority of recipients could not possibly be agents of the federal government. They include "States and local governments, educational institutions. . ." and other organizations "outside the Federal Government", 31 C.F.R. §§205.1, 205.2 (1976). Advanced funding is intended to "enable a recipient organization to obtain cash from Treasury promptly. . ." based upon "its own determination" of how much is needed "for its disbursements", *id.*, §205.5.

The mechanics of advanced funding do not accord a supplier a claim directly against the United States. At no time is a third party able to draw directly on a federal reserve bank against a contractor's letter of credit, R.VI, McGrath depo., 21-22. Funds are drawn into the contractors' local accounts only if, and only after, the contractors have issued checks to their obligees, J.A. 109-110. If no drawdown is made, there is no fund for an unpaid supplier to go against. The great significance attributed by the United States to its ownership of the funds in these accounts turns on preservation of a lien, not creation of an agency relationship. The general statute authorizing advanced

funding, 41 U.S.C. §255(c), requires adequate security which "may be in the form of a lien in favor of the Government . . . on the balance in an account in which such payments are deposited". This lien concept is evidenced in the AEC contractors' agreements with their local banks and the United States which provide that title to the funds is retained by the United States "to secure the return of all advances made to the Contractor", J.A. 85, 87. Having reserved a lien for itself, the United States has clearly not exposed the funds to claims by unpaid suppliers.

The issue is not whose funds are being used but rather whose obligations are being satisfied. So long as the contractors' employees are not federal employees and so long as purchase documents identify the contractors as the buyers, the advanced funds satisfy the contractors' obligations and are taxable gross receipts to them. The United States' obligation to provide funds runs only to the contractors themselves. If advanced funding is coextensive with agency, then the 162 similarly-financed contractors within the Atomic Energy Commission are agents, as are the 10,000 recipients outside the federal government. The United States repeatedly emphasizes the "standard" nature of the New Mexico contracts, U.S. Brief, 3, 15-17, 26-28, 39, 40, asserting that it is advanced funding, not some unique designation of the New Mexico contractors, that makes them agents. This stands *Kern-Limerick* on its head.

Two years after this case commenced, the United States and the contractors entered into contract modifications effective July 1, 1977, J.A. 49, 54, 58. As the United States put it, "anticipated issues in the litigation were the motivating factor", Plaintiff's Opposition to Defendants' Motion to Compel Discovery, 3, namely, "to save $10 million per year", R.III, Defendants' Cross-Motion, ex. 11. Their promulgation does nothing but evidence AEC's own perception of how weak its case was up to that point.

While the modifications provide that each contractor "acts as an agent" for the AEC, J.A. 50, 55, 59, it is conceded that this language does not "formally and directly designat[e] the contractors as agents", J.A. 64. Similarly, although the modifications state that each contractor "is authorized to pledge the credit of the United States", J.A. 51-52, 56, 60, it is conceded that "[t]he word 'is' was not intended to imply that these are words of present authorization", J.A. 64. These qualifications render the modifications a wistful set of arguments as to why advanced funding "establish[es]" an agency relationship, J.A. 50, 55, 59, not a legally operative designation of status. The modifications do not strengthen the United States' assertions regarding advanced funding, they only summarize them.

The fact that Sandia Corporation receives no fee under its cost contract does not exempt it from the New Mexico tax. In *United States v. Boyd,* 378 U.S. 39 (1964), this Court distinguished the use tax exemption accorded a no-fee contractor in *Livingston v. United States,* 364 U.S. 281 (1960), (*per curiam*), *aff'g* 179 F.Supp. 9 (E.D.S.C. 1959), based on the "factual determination that du Pont received no benefits from the contract", 378 U.S. 45, n. 6. The United States minimizes the impact of *Livingston* as applied to Sandia in this case, U.S. Brief, 22-26, and New Mexico concurs, albeit for different reasons. While a no-fee contract might negate the "separable beneficial and taxable use" necessary for use tax liability, *Livingston, supra,* at 22, the same is not true of a tax on receipts relating to a contractor's obligations to its own employees and suppliers. Furthermore, Sandia and its profit-making parent, also a party to this contract, received $312,000 in salary reimbursements, royalty-free licenses and additional payments for audit services and supervision, J.A. 35, 40-42, R.IV., Interrog. 40, Aug. 31, 1976. AEC's own regulations, making receipt of a fee a matter of negotiation, J.A. 211, indicate

no intent that a no-fee contract is indicative of an agency relationship.

Besides *James v. Dravo Contracting Company, supra,* the controlling case here is clearly not *Kern-Limerick* but *United States v. Boyd, supra,* in which this Court held that run-of-the-mill AEC management contractors are neither federal agents nor instrumentalities although they are financed with "government funds" and are relieved of all risk by their cost-plus contracts. Although *Boyd* involved a use tax, this Court's refusal to read an agency relationship into standard contract clauses transcends the particular tax at issue and is dispositive of the present case. While the United States cannot prevail under *Kern-Limerick,* New Mexico urges that this Court abandon this judicially-created exception to the general application of non-discriminatory state taxes to federal contractors. Absent a definitive expression from Congress that federal contractors should escape state taxation, the practice of selectively immunizing contractors through contractual manipulation by the Executive Branch is unjustified. As this Court recently held in a commerce clause context, "[i]t would be strange indeed if the legality of a tax could be made to depend on the vagaries of the terms of contracts", *Commonwealth Edison Co. v. Montana,* 49 U.S.L.W. 4957, 4960, n.8 (1981).

I. THE CONTRACTORS HERE ARE NOT FEDERAL PROCUREMENT AGENTS. THEY ARE LIABLE FOR THE NEW MEXICO GROSS RECEIPTS AND COMPENSATING TAXES ON THE FUNDS USED TO PAY THEIR EMPLOYEES AND SUPPLIERS.

In *James v. Dravo Contracting Company,* 302 U.S. 134 (1937), this Court upheld the application of a non-discriminatory state gross receipts tax to the receipts of a federal contractor. So long as the legal incidence of the tax fell on the contractor, the fact that the economic burden passed to the United States

did not bar the tax. In the present case, the court of appeals upheld the application of just such a gross receipts tax as was approved in *James v. Dravo* to the receipts of three Atomic Energy Commission[1] contractors performing under contracts in New Mexico. The United States concedes that, absent a finding that these three Atomic Energy Commission contractors are federal agents, "the legal incidence of both the New Mexico gross receipts and compensating use tax is on the contractors", U.S. Brief, 25.

To avoid this result the United States asserts that the three AEC contractors are tax-immune federal "procurement agents", U.S. Brief, i, by virtue of *Kern-Limerick, Inc. v. Scurlock*, 347 U.S. 110 (1954). This case held that federal contractors were insulated from state sales taxes in their dealings with suppliers where their contract and purchase orders rendered the United States the "disclosed purchaser". The contract there provided that "The Contractor shall act as the purchasing agent of the Government" and that "the Government shall be directly liable to the vendors for the purchase price", 347 U.S. 110, 113, n.2. Similarly, the purchase orders sent to third parties stated that "This purchase is made by the Government. The Government shall be obligated to the Vendor for the purchase price. . ." and that "The vendor agrees to make demand or claim for payment of the purchase price from the Government. . .", at 119. As the court of appeals in the present case observed, "under *Kern-Limerick* a federal agency may bring a contractor within the scope of intergovernmental immunity if a decision to create an agency relationship is made in advance of a dispute and is *unequivocally expressed* in all relevant documents," Pet.App. 17a, emphasis added.

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[1] In this brief, the agencies with which the contractors are affiliated are referenced interchangeably as the Atomic Energy Commission ("AEC"), the Energy Research and Development Administration ("ERDA"), and the Department of Energy ("DOE"), as the context requires.

To fit *Kern-Limerick* to a gross receipts tax situation, the United States implicitly argues that, to the extent the contractors acted as "procurement agents" in performing their contractual services, their receipts under their cost-plus contracts[2] are insulated from the New Mexico tax. The United States' immediate dilemma is that fifty-eight percent of the contractors' gross receipts went to meet their own payrolls, employee benefit packages and internal costs, R.IV, Interrogs. 36, 52, Aug.. 31 and Oct. 15, 1976, rather than obligations to suppliers. To come within the *Kern-Limerick* tests, the United States must distort the phrase "procurement agent" to include "procurement" by the contractors of their own employees, U.S. Brief, Question Presented, i; 34. Such a claim is unreasonable on its face. Even a genuine agent, immune from tax on the funds which he handles in transactions on behalf of his principal, would experience taxable receipts on payments from the principal to meet the agent's own staff salaries, internal expenses, and profit, *Westland Corp. v. Commissioner,* 84 N.M. 327, 503 P.2d 151 (Ct. App. 1972).

The contractors collectively employ 7,400 employees, R.IV, Interrogs. 37, 71, ex. 2, Aug. 31, 1976. The tasks which these employees perform are indistinguishable from those of other contractors working for the federal government, R.IV, Interrog. 24, ex. 9, Aug. 31, 1976; Interrog. 65, ex. 8, Oct. 15, 1976. The United States concedes that the three management contractors "may be . . . 'independent contractor[s]', rather than . . . 'servant[s]' for . . . directing the details of day-to-day research or maintenance operations and *the hiring and direct supervision of employees. . .*", J.A. 197, emphasis added. The United States further concedes that contractor employees are not government

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[2] One contractor, Sandia, has a cost contract only, since it receives no fee, U.S. Brief, 2.

employees and denies any tort liability arising from "negligence on the part of contractor employees", J.A. 200.[3] Given these facts and the accompanying concessions, it is the contractors, not the United States, which have the obligation of paying these employees. Any funds received from the United States to meet the contractors' recurring payroll and benefit packages constitute receipts to the contractors of a major cost of conducting their business. The United States also concedes that its contractors, despite their status as "procurement agents", *do* owe gross receipts tax on their contractual fees which are "paid by the contractors to themselves from the special Government bank accounts", R.IV, Interrog. 55, Aug. 31, 1976. Having conceded taxable receipt of their fees, the contractors cannot deny equal receipt of, and benefit from, the funds used to meet their obligations to their employees, with whom they deal independent of any "procurement agent" status.

The remainder of the contractors' receipts relate to transactions with suppliers, but the contractors do not function as procurement agents. Nowhere in Zia, LACI and Sandia's contracts and purchase orders are the contractors designated an "agent",[4] empowered to act "on behalf of" or "for the account

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[3] This conforms to the United States' position in *United States v. Boyd*, 378 U.S. 39 (1964), in which it was "not argued that Carbide's 12,000 men have somehow become employees of the Commission rather than of Carbide", at 47-48.

[4] The United States correctly observes that the Tennessee Supreme Court in *United States v. Boyd*, 211 Tenn. 139, 363 S.W.2d 193 (1962), *aff'd*, 378 U.S. 39 (1964), held that the precise use of the word "agent" is not indispensable to finding an agency relationship, U.S. Brief, 39. The same observation was made in *Livingston v. United States*, 179 F.Supp. 9, 22 (E.D.S.C. 1959), *aff'd per curiam*, 364 U.S. 281 (1960). However, the purchase orders in the latter case specified that purchases were "for the benefit of the United States Government", arguably satisfying the *Kern-*

(Cont. p. 14)

of" the government or to "bind the government in any way," R.IV, Interrogs. 11 and 12, Aug. 13, 1976; Interrogs. 11 and 12 Feb. 7, 1977.[5]

The contracts and purchase orders have much language indicating a contrary intent. Negating any notion that Sandia, for example, may bind the government in contract is the flat provision that, "All purchase orders, subcontracts, and other commitments shall be made in the name of Sandia Corporation . . .", J.A. 36-37, emphasis added. Similar intent is expressed in

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[4] (Cont. from p. 13)

Limerick test of disclosed agency. The purchase orders in the *Boyd* case were equally explicit, see page 21, *infra. United States v. Nevada Tax Commission*, 291 F.Supp. 530 (D.Nev. 1968), *aff'd*, 439 F.2d 435 (9th Cir. 1971) never discusses the significance of omitting the word "agent" although it is cited by the United States for that proposition, U.S. Brief, 40. The district court's determination that the United States was the purchaser there was not appealed to the Ninth Circuit. Indeed, the State of Nevada stipulated on appeal that the United States *was* the purchaser, 439 F.2d at 439. The district court opinion is devoid of the factual development in the present record and should not be controlling here, particularly in view of the United States' position in an earlier tort case that the same contractor was *not* its agent, see page 23, *infra.*

[5] Exceptions are purchases by Sandia and Zia from Defense Supply Centers, as to which requisition forms stating that the contractors are "acting on behalf of and as agent for the U.S. Energy Research and Development Administration with respect to the expenditure of Government funds" are utilized, R.V, Vol. 1, exs. 12-S, 12-AF, Feb. 1, 1977. Forms for purchases pursuant to prices negotiated by the General Services Administration, utilized by Sandia and Zia through 1969, stated that they were authorized to "act as agent for" the Commission, but this language was deleted thereafter, *id.*, compare R.V, Vol. 1, exs. 12-W and 12-Y, and 12-AL and 12-AM. Insertion or deletion of such language was "based upon, and varies according to, the requirements of applicable regulations of GSA [General Services Administration] or other Government agencies responsible for such Government supply sources", R.IV, Interrog. 12, Aug. 31, 1976.

the provision that "Sandia Corporation shall . . . be responsible for determining the kind and quantity of materials to be procured, selection of and negotiations with suppliers, negotiation of price or price basis and other purchase terms and conditions . . .", J.A. 36. Rather than placing the contractors under the United States' direct control, it is provided that "Western [Sandia's parent company] shall be responsible for, and shall supervise, performance by Sandia Corporation of its obligations [relating to personnel practices and procurement]," J.A. 37.

Similar intent is expressed in the contractors' internal Purchasing Instructions, approved by the United States, J.A. 36-37, which admonish employees to "CONSIDER FIRST THE INTERESTS OF SANDIA", to act with "utmost loyalty to Sandia", to be "a money manager for Sandia", to make sure they are "getting the best deal for Sandia" before committing "Sandia Corporation funds" and caution them to avoid "the risk of monetary loss to Sandia", R.III, Defendants' Cross-Motion, ex. 10, emphasis in the original.

The contractors' "Standard Terms and Conditions" accompanying all purchase orders distinguish between the "Government" and the "Buyer" who is placing the order. In the case of Zia, for example, the "Buyer" is not the United States but "THE ZIA COMPANY in the performance of the prime contract W-17-028-ENG-90 with the United States of America and includes any duly authorized representative thereof." J.A. 120, emphasis in the original.

These same Standard Terms and Conditions define "Government" to mean only "the United States of America," J.A. 120, para. 1(d). Clearly, the "Buyer" is the contractor, not the separately-defined "Government". Since the government can compel the inclusion of any clauses it wishes in these purchase

orders, J.A. 36-37, the absence of any indication that the contractors are agents is significant and probative.[6]

The United States identifies four tests of an agency relationship in *Kern-Limerick*, and argues that these contractors satisfy them, U.S. Brief, 29, *et seq.* In fact, they do not. As to "governmental approval of purchases", the United States concedes that the contractors in *Kern-Limerick* required advance approval by the United States of *all* purchases, 347 U.S. at 120, while the contractors here operate with "greater autonomy", U.S. Brief, 31. The United States' identification of "immediate passage of title [to purchases] from the vendor to the government" as a test of agency, U.S. Brief, 29, is incorrect since this Court has

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[6] The contracts provide certain alternative procedures to those commonly employed which, *if exercised,* might arguably make the contractors into federal agents so long as those procedures were utilized. For example, the contractors' purchase orders are potentially ". . .assignable by Buyer to the Government or its designee," J.A. 138. Similarly, "ERDA can elect to make payment. . . directly to the obligees [for] obligations properly incurred [by the contractors]", R. II, Plaintiff's Motion, Points and Authorities, 7. Also, contractors could be required to make "such. . . payments on behalf of ERDA as ERDA shall specifically direct," *id.*, 7, or "procure . . . items for the use of the Commission and other Commission contractors as may be required by the Contracting Officer from time to time. . .," J.A. 20.

It can be seen that *if* purchase orders are assigned to the government, *if* the government paid the contractors' suppliers directly, *if* the government directed the contractor to make payments on its behalf and *if* the government told the contractors what to buy, *then* the contractors might indeed be functioning as agents of the government for those activities. *In other states, ERDA has deliberately structured purchases by contractors so that the government paid the suppliers directly, avoiding state taxes,* J.A. 163-173. But Zia, LACI and Sandia *have never performed any activities pursuant to these provisions,* R. IV, Interrogs. 46, 61, 69, 88, 113 and 117, Aug. 31, 1977; Interrogs. 68 and 100, Oct. 15, 1976. If the contractors were intended to be ERDA's agents in purchasing pursuant to the standard procedures, there would be no need for these alternative procedures.

held that "The circumstance that the title to the lumber passed to the Government on delivery does not obligate it to the contractor's vendor. . .", *Alabama v. King & Boozer*, 314 U.S. 1, 13-14 (1941).[7]

The only evidence proffered to satisfy the third test, "specific notice" of an agency relationship, U.S. Brief, 29, are the legends on checks utilized by Zia and LACI since 1975 and by Sandia since 1976, U.S. Brief, 31. These have the phrases "A.E.C. Advanced Funds" or "Advance Funds Accounts" in the printed portions of the checks, J.A. 99-101. Since the Standard Terms and Conditions sent to suppliers already identify the contractors as the "Buyer[s]", J.A. 120, the check legends only notify obligees of the contractors' funding mechanism. When compared to the emphatic language of the *Kern-Limerick* purchase orders, there is no justification for gratuitously reading an agency relationship into the language on the checks. It may be, as the United States contends, that obligees are aware that they are dealing with federal contractors whose funds ultimately come

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[7] Similarly, in *United States v. Boyd, supra*, the fact that "title to all property passes directly from the vendor to the United States", at 41-42, did not hinder this Court's determination that the contractors were not agents. As further evidence of an agency relationship, the United States also identifies provisions that the United States bears the risk of loss, retains control of the disposition of purchases and approves the contractors' property management procedures, U.S. Brief, 20. These provisions are frequently found in the contracts of obvious non-agents and are irrelevant to the determination of the contractors' purported status as agents. In *United States v. Boyd*, the United States had to approve purchases above a certain amount, controlled "large areas of operation", at 42, and relieved the contractors of all risks, at 44. Equivalent clauses are found in Defense Department contracts, which specifically provide that the contractors are *not* agents, reflecting the Defense Department's blanket policy against designating contractors as agents, see *United States v. New Mexico*, 581 F.2d 803, 804-805, 807, 808, n.1 (10th Cir. 1978) and *United States v. Forst*, 442 F.Supp. 920 (W.D.Va. 1977), *aff'd*, 569 F.2d 811 (4th Cir. 1978).

from the United States, U.S. Brief, 32, n.12. But that is true as to every federal contractor, not just those which are agents, and proves nothing. The fact that cost-plus contractors "in a loose and general sense were acting for the Government," is not sufficient to immunize them from state taxes, *Alabama v. King & Boozer*, 314 U.S. 1, 12 (1941). To be bound on a contract, there must be a "disclosed principal" and an "understanding that the principal is a party", Restatement (Second) of Agency, §144. Here, there is neither the disclosure nor the understanding.

The fourth test, "explicit characterization" of the contractors as agents, U.S. Brief, 29, is purportedly satisfied by the contractors' reliance on "advanced funding" to finance their operations, and by certain contract modifications effective July 1, 1977, *id.*, 32, 35. These are analyzed in Sections II and III of this brief. As will be seen, the modifications stop short of being explicit designations of the contractors as agents, J.A. 64, and simply reference the advanced funding arrangement as the proof of the agency relationship. Earlier in this case, the United States conceded that, while "[t]he agency relationship in *Kern-Limerick* was express", the purported relationship here was only "implied", R.III, Plaintiff's Opposition to Defendants' Cross Motion For Summary Judgment, 10. Now, the United States hangs its entire case on the contention that an element of the contractors' operational style, advanced funding, constitutes the sort of express designation of agency approved in *Kern-Limerick*.

The United States' motivation is clear. Having failed to expressly designate its New Mexico contractors, it must claim that their style of operation establishes an agency relationship. To insert *Kern-Limerick* language here and prevail would expose all its undesignated contractors in other states to taxation. Therefore, the United States repeatedly emphasizes the "standard" nature of the New Mexico contracts, U.S. Brief, 3, 15-17, 26-28, 39, 40, asserting that it is advanced funding, not some

unique designation of the New Mexico contractors, that makes them agents. This rationale stands *Kern-Limerick* on its head.

Additionally, this approach cannot avail the United States because this Court has already scrutinized run-of-the-mill AEC management contractors and concluded that they are neither federal agents nor instrumentalities by virtue of their style of operation, *United States v. Boyd*, 378 U.S. 39 (1964). The Tennessee contractors there were obligated to "manage, operate and maintain the Oak Ridge plants", at 41, although having "no investment" in them, at 42. They were "charged with the duty of procuring materials, supplies, equipment and facilities", at 41, paid for their purchases with "government funds", and caused title to their purchases to pass "directly from the vendor to the United States", at 41-42. The Atomic Energy Commission retained "the right to control, direct and supervise the performance of the work", at 42.

Nevertheless, this Court concluded that neither contractor was "so incorporated into the government structure as to become instrumentalities of the United States and thus enjoy governmental immunity", at 48. There was no special immunity arising from work for the Atomic Energy Commission: "In 1953, Congress repealed the statutory immunity for activities and properties of the AEC contained in §9(b) in order to place Atomic Energy Commission contractors on the same footing as other contractors performing work for the Government", at 40.

The Tennessee management contractors receiving advances of "government funds" were simply another species of cost-plus contractor, "a widespread method of contracting with the Government", at 46. Indeed, "[w]hatever limitations there are on entrepreneurial risks derive from the fact that companies perform under cost-plus-fixed-fee contracts", at 46.

This Court, perhaps with *Kern-Limerick v. Scurlock* in mind, recognized that Atomic Energy Commission operations did not

have to be subject to state taxes. In its enabling legislation, ". . . Congress empowered the AEC to choose between performing these undertakings directly, through its own facilities, personnel and staff, and seeking the assistance of private enterprise by means of grants and contracts," at 47. Therefore, "[s]hould the Commission intend to build or operate the plant with its own servants and employees, it is well aware that it may do so and familiar with the ways of doing it. *It chose not to do so here*", at 48, emphasis added.

Reading an agency relationship into the AEC contractors' style of operation must also fail because the AEC itself never intended that the relationship with its management contractors would, without express designation, be that of principal and agent. Asked whether AEC contractors were "more an agent of the Government than . . . a prime contractor for the Defense Department?", an AEC commissioner responded, "*I would not classify the overall relationships as one of 'agency' in the legal sense. . .*[W]e believe that it is close to being an agent *but is not legally so,*" J.A. 175, emphasis added.

The Commission's stated practice has been to specifically designate a contractor as an agent when it wants the contractor to be one. Thus, "the relationship and control [of the Commission over its contractors] is not so close in fact as to constitute a general or specific agency, *except where so expressly stated. . .*", Ramey and Erlewine, *Introduction to the Concept of the "Administrative Contract" in Government Sponsored Research and Development,* 17 Fed. B.J. 354, 358-359 (1957), emphasis added.

Consistent with this policy, the Atomic Energy Commission "has found it advantageous to enter into . . . *contracts expressly designating the contractor as agent*" for community management, purchases from government supply sources and "for the purpose of administering many substantial procurement con-

tracts which were placed directly by the Commission. . ." Testimony of David Shaw, *Hearings Before a Subcomm. of the Comm. on Gov't Operations, 85th Cong., 1st Sess., on S.6,* June 11 and 12, 1957, 66-67, [emphasis added]. See also, J.A. 216-217. Such agency designations were explicit. Thus, an early AEC contract provided "in the operation of the facilities under this contract, and in the procurement of any and all supplies . . . the Contractor shall act as agent for the United States of America. . .", R.III, Defendants' Cross-Motion, ex. 9, 2. Similarly, the AEC approved purchase orders sent to suppliers by another contractor which provided that "this Order is entered into . . . for and on behalf of the Government", and that ". . . nothing herein shall preclude liability of the Government for any payment properly due hereunder. . .", *United States v. Boyd,* 363 S.W.2d 193, 199 (Tenn. 1962).

These examples notwithstanding, explicit designation of agents rarely occurred, J.A. 216. This resulted from what its Assistant General Counsel termed "a continued reluctance to designate AEC contractors expressly as procurement agents", Hiestand and Florsheim, *The AEC Management Contract Concept,* 29 Fed. B. J. 67, 81 (1969).[8] In the same vein a regional attorney noted that "AEC Washington" was "adverse to use of the term ['agent'] in prime contracts" in the mid-1950's, J.A. 181. This "reluctance" stemmed from strong and continuing

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[8] This "reluctance" is somewhat startling because the Atomic Energy Commission has been highly sensitive since its inception to the need to insulate its contractors from state taxes and to the benefits of attributing an agency status to them. This is evidenced in lengthy submissions to Congress on several occasions resisting legislation which would have eliminated agency as a defense to state taxes, or otherwise exposed AEC contractors to additional taxes, R.V, exs. 22-U, 22-V, 22-W, 22-AA and 22 AE. It is further evidenced in sophisticated analyses of the avenues for avoiding state taxes following this Court's decision in *Kern-Limerick, Inc. v. Scurlock* in 1954, R.V, ex. 22-AB.

policy motives. AEC has been concerned since its inception that designating its contractors as agents would force them to follow all the Federal Procurement Regulations, the sort of red tape that the "management contract concept" was meant to avoid. As Commissioner Ramey noted, "[t]he early AECPR's [Atomic Energy Commission Procurement Regulations] contained language which implied that our contractors in their procurements were to be bound by the same regulations as were binding on direct AEC procurement", R.V, Vol. 2, ex. 22M, 5. Similarly, Assistant General Counsel Hiestand wrote that "[t]he designation of management contractors as purchasing agents caused concern in the early days of AEC, based on the argument that a purchase by an agent was subject to the same legal requirements applicable to direct procurement. . . . Although the fears about procurement through an agent-contractor were largely dispelled by the Supreme Court in *Kern-Limerick, Inc. v. Scurlock, there has been a continued reluctance to designate AEC management contractors expressly as procurement agents*", Hiestand and Florsheim, *supra*, 80-81, emphasis added.

This "continued reluctance" was an enduring element of policy as shown by a 1969 exchange between a Congressional committee aide and an AEC commissioner:

Mr. Roback:	But in all these other areas, the fact that a contractor, *not the Government*, is doing the contracting in a large way exempts these agencies legally from all procurement laws and regulations.
Mr. Ramey:	Not from all, but from some.
Mr. Roback:	Not from all, but in a large way, I say.
Mr. Ramey:	Yes; at least, with respect to the procurement statutes.

J.A. 177, emphasis added.

A 1968 AEC report on contractor procurement rejected a proposal to "[c]onsider the contractors as agents of the Government and require that they follow strictly the FPR and AECPR in their procurement activities. . .," J.A. 183-184, [abbreviations refer to the Federal Procurement Regulations and Atomic Energy Commission Procurement Regulations]. Obviously, if the contractors were already agents by virtue of their mere association with AEC, there would be no need to "consider" them as agents by a new policy formulation.

AEC has consciously refrained from designating its contractors as agents to benefit from their freedom in procurement, *precisely the function for which an agency relationship is now claimed to avoid taxes!* But where the designation is deliberately omitted to gain the benefits of non-agent status, a claim that the contractors are procurement agents must fail.[9]

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[9] AEC has additional motivations for consciously omitting agency terminology from its contracts. AEC routinely asserts that the same contractors which it styles "agents" in tax cases are "independent contractors" in tort cases, R. IV, Interrogs. 98 and 99, Aug. 31, 1976; R. IV, Interrogs. 98 and 99, Feb. 7, 1977. This fluid switching of legal positions would be jeopardized if contractors were formally designated as agents. Illustrative of this practice, in a tort case involving the Reynolds Electrical & Engineering Company (REECO) in 1976, "The AEC contend[ed] that the government cannot, under the Tort Claims Act, be held liable for injuries resulting from the negligence of Reeco, *its independent contractor.* . .", *McGarry v. United States,* 549 F.2d 587, 590 (9th Cir. 1976), emphasis added. Two years later, in a tax case involving the same contractor, the United States took a different stance and successfully argued that sales to REECO "are *sales to the United States* immune from the Nevada Sales Tax", *United States v. Nevada Tax Commission,* 291 F.Supp. 530, 533 (D.Nev. 1968), *aff'd,* 439 F.2d 435 (9th Cir. 1971), emphasis added. While ERDA has not had occasion to argue that Zia and LACI in particular are independent contractors, "[p]laintiff admits that it would take such a position, if otherwise appropriate, in the context of a tort claim against the United States, as admitted with respect to management contractors generally. . .", R. IV, Interrog. 98, Feb. 7, 1977.

II. "ADVANCED FUNDING" MEETS THE UNITED STATES' CONTRACTUAL PAYMENT OBLIGATIONS TO THESE CONTRACTORS. IT DOES NOT CREATE AN AGENCY RELATIONSHIP INSULATING THE CONTRACTORS FROM STATE TAXES.

The United States argues that the contractors are paying their obligees with "the federal government's funds", U.S. Brief, i, and that, therefore, they are procurement agents in disbursing these funds, *id.*, 28. Two decisions by this Court point up the error in this reasoning. In the use tax portion of *United States v. Boyd, supra,* this Court found the contractors to be neither agents nor federal instrumentalities although the contractors paid for their purchases "with government funds", at 41-42. After that decision, those contractors had to pay their use tax from these same "government funds", Record at 6, *United States v. Boyd,* 378 U.S. 39, Original Bill, para. VIII. In doing so, the contractors acted, not as disbursement agents of the government, but as taxpayers meeting their own obligations. In contrast, the contractor in *Kern-Limerick, Inc. v. Scurlock* was held an agent although he did *not* receive advanced funding. This does not suggest a "stronger case for immunity" if a contractor receives advanced funding, U.S. Brief, 14; rather, it suggests that *the issue is who bears the obligation, not whose funds are used.*

Presumably, the United States would concede that not every contractor paid in advance automatically becomes an agent of his customer. Many a person commissioning a new house has paid his contractor in advance for precisely the same reasons the United States does so: to avoid financing costs, to permit retention of a contractor having limited access to credit, and to keep better control over expenditures. The customer's obligation to supply funds runs only to the contractor. Although the contrac-

tor is using "the customer's funds", he does so to meet *his own* obligations to his employees, his suppliers and himself. Thus, the issue is not whose funds are being used, but whose obligations are being satisfied. There is no basis for claiming that advanced funding automatically equals an agency relationship, yet that untenable claim is at the heart of the United States' case.

To briefly reiterate points from the preceding section, Zia and LACI (the two contractors receiving fixed fees) concede that they do owe New Mexico gross receipts tax on their fixed fees which "were paid by the contractors to themselves from the special Government bank accounts", U.S. Brief, 6; R.IV, Interrog. 55, Aug. 31, 1976.[10] Despite the uniqueness attributed to these accounts, and the limitations on the contractors' use of the funds deposited in them, it is conceded that these funds *can* become taxable gross receipts of the contractors. With this concession in hand, the funds used to meet the contractors' extensive payrolls and obligations to suppliers must constitute receipts as well. So long as the contractors' employees are not federal employees and so long as purchase documents sent to third parties identify the contractors as the buyers, the advanced funds satisfy the *contractors'* obligations.

The mechanics of advanced funding do not accord a supplier a claim directly against the United States. At no time is a third party given the power to draw directly on a federal reserve bank against a contractor's letter of credit, R.VI, McGrath depo., 21-22. Funds are drawn into the contractors' local accounts

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[10] More accurately, it is the United States which advances an amount equal to the contractors' fees, a computation determined in the first instance by the contractors themselves under the mechanics of the advanced funding arrangement.

only *if*, and only *after*, the contractors have issued checks to their obligees, J.A. 109-110. If no drawdown is made, there is no fund for an unpaid supplier to go against. The great significance attributed by the United States to its "ownership" of the funds in these accounts turns on preservation of a lien, not creation of an agency relationship. The general statute authorizing advanced payments, 41 U.S.C. §255(c) (1981), requires adequate security for advanced funds which "may be in the form of a lien in favor of the Government. . . on the balance in an account in which such payments are deposited". This lien concept is evidenced in the AEC contractors' agreements with their local banks and the United States which provide that the title to the funds retained by the United States is "to secure the return of all advances made to the Contractor", J.A. 85, para. 2; 87, para. 2.[11] A similar agreement applicable to all federal contractors is found at 41 C.F.R. §1-30.414-1 (1980). Having reserved a lien for itself, the United States has clearly not exposed the funds to any claims by unpaid suppliers.

Although the district court found that "[t]he advanced funding scheme is not a system by which the contractors are *reimbursed* for their direct costs under the contract", and therefore concluded that the contractors were "not the same as the typical cost-plus-fixed-fee contractor", Pet.App. 5a, emphasis added, this finding is at variance with the AEC's own long-

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[11] As a practical matter, funds are only drawn into the accounts by the contractors after they have issued checks to specific obligees, R. VI, McGrath depo., 14-15. Under an alternative arrangement, the local bank advances funds to cover the contractors' checks and then draws funds from the federal reserve bank to reimburse itself, *id.*, 15. Under this second arrangement, the funds never enter the "special" bank accounts at all. Even under the first arrangement, the concept of the United States "owning" funds already earmarked for specific obligees has little significance.

established policy in utilizing advanced funds.[12] AEC instituted an "integrated" accounting system shortly after it came into being, J.A. 189. Far from transforming its contractors into agents, its purpose was to "speed up *reimbursement* of contractors", J.A. 204, emphasis added. Central to this new system was the use of "advanced funds", J.A. 190, authorized under §4(c)(2)(B) of the Atomic Energy Act of 1946, now 42 U.S.C. §2061(b) (1981). Their use, subject to later audit, replaced the "customary procedure in the audit of certain contracts . . . resulting in a triple item-by-item voucher check", J.A. 187.

Despite the shift to advanced funding, AEC continued to view its contractors as "cost-reimbursed operating contractors", J.A. 189. The fact that a major contractor's accounts were "integrated" did not relieve it of a later "*reimbursement* audit" performed by the Atomic Energy Commission, J.A. 191, emphasis added. Thus, although the contractor had the use of the advanced funds, after subsequent audit they were credited against the amounts otherwise subject to reimbursement. The cost-reimbursement language in the contracts in the present case is not an anomaly to be disregarded, as the district court found it to be, Pet. App. 5a. Advanced funding is an advantageous way of paying contractors, not of empowering them to pledge the credit of the government.

Advanced funding is not unique to these contractors nor to the Atomic Energy Commission. It is a funding mechanism

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[12] The district court's finding is also at variance with specific contract clauses assuring that all the contractors' costs will be "reimbursed" by the United States, J.A. 31, and constitute their "compensation", J.A. 18, and establishing an elaborate system for periodic audit and approval of the contractors' vouchers submitted subsequent to expenditure of the advanced funds, J.A. 20, U.S. Brief, 30. It also conflicts with the holding in *United States v. Boyd, supra,* that contractors paid with "government funds" are merely a species of cost-plus-fixed-fee contractor, 378 U.S. 39, 46.

administered by the Treasury Department and available to any federal agency having a relationship with a private entity for longer than one year and for more than $250,000, R.VI, McGrath depo., 7-8. All recipients, including the AEC contractors, are governed by the Treasury Regulations appearing at 31 C.F.R. Part 205, *id.*, 6. The AEC contractors number a mere *one hundred and sixty-five out of a total of 10,369 current recipients, id.*, 9. The majority of recipients could not possibly be agents of the federal government. They include "State and local governments, educational institutions, . . ." and other organizations "*outside* the Federal Government. . .", 31 C.F.R. §§205.1, 205.2 (1976), emphasis added. Current recipients in New Mexico include such obvious non-federal-agents as the towns and cities of Red River, Tularosa and Albuquerque, New Mexico Highlands University, and Six Sandoval Indian Pueblos, Inc., R.VI, McGrath depo., exs. A and B.

Included in the record are affidavits from five of these New Mexico holders of federal letters of credit, J.A. 114-119, R.III, Defendants' Cross-Motion, exs. 2-5. They rely exclusively on federal letter of credit funds to finance particular operations or, in some cases, their entire cost of operation. They do not commingle the federal funds with others. They write checks directly on these letter of credit accounts to cover salaries, materials, supplies and services. They draw on the federal reserve bank through their local bank without any prior clearance from the government. In short, they utilize these accounts exactly as the AEC contractors do, yet they clearly are not federal agents, *id.*

Of particular interest is the affidavit from the New Mexico Professional Standards Review Organization, J.A. 114-119. Its banking arrangements include an agreement among the United States, the bank and the Organization, which is virtually identical to the "special" agreements executed by Sandia, Zia and LACI, J.A. 117-119. Lacking any exemption under New Mexico's tax laws, (such as that afforded a "501(c)(3)" organization

under §72-16A-12.17, N.M.S.A. (1953)), the New Mexico Professional Standards Review Organization routinely "*pays. . . New Mexico gross receipts tax on its payments from the Department of Health, Education and Welfare.*" Furthermore, "[t]hese tax payments are allowable costs reimbursed by the federal agency", J.A. 115, emphasis added.

The letters of credit are intended to "enable a recipient organization to obtain cash from Treasury promptly . . ." based upon "*its own determination*" of how much is needed "for its disbursements", 31 C.F.R. §205.5 (1976), emphasis added. Only a designated recipient is empowered to draw on the Treasury, R.VI, McGrath depo., 21. This power cannot be delegated to third parties, *id.*, 21-22. From the Treasury's point of view, the purpose of advanced funding is solely to delay the draw down on the federal treasury as long as possible to increase the "float" on federal funds, *id.*, 13-16. Negating the United States' contention that the funds "do not pass through the contractors", R.II, Plaintiff's Motion, Points and Authorities, 7, is the requirement of semi-annual reports of "cash balances *in the hands* of the recipient organizations. . .", 31 C.F.R. §205.9 (1976), emphasis added.

Thus, advanced funding is simply a standard mechanism, one of several, by which the United States meets its obligations to its contractors. If these Atomic Energy Commission contractors are agents by virtue of advanced funding, then so are the ten thousand recipients outside the federal government and so are the 162 other recipients *within* the AEC, 102 of whom are not even management contractors, compare R.IV, Interrog. 21, ex. 8, Aug. 31, 1976, and R.VI, McGrath depo., 9. If advanced funding is coextensive with agency, virtually every large Atomic Energy Commission contractor would be an agent purely by virtue of its style of operation, a result which Congress apparently meant to avoid in repealing §9(b) of the Atomic Energy Act of 1946 following the decision in *Carson v. Roane-Anderson*

Co., 342 U.S. 232 (1952). These repercussions both within and without the Atomic Energy Commission are so implausible as to mandate the conclusion that advanced funding does not create an agency relationship between the United States and its contractors.

III. THE JULY 1, 1977, CONTRACT AMENDMENTS STOPPED SHORT OF EXPRESSLY DESIGNATING THE CONTRACTORS AS AGENTS. IF THE CONTRACTORS WERE NOT AGENTS BEFORE, THE MODIFICATIONS DID NOT CHANGE THEIR STATUS.

Two years after this case commenced, the United States and the contractors entered into contract modifications effective July 1, 1977, J.A. 49, 54, 58. As the United States put it, "anticipated issues in the litigation were the motivating factor for the modifications", Plaintiff's Opposition to Defendants' Motion to Compel Discovery, Sept. 7, 1977, 3, this issue being "to save $10 million per year", R.III, Defendants' Cross-Motion, ex. 11.[13] More precisely, they were intended to "show that ERDA [AEC's successor] . . . is willing to use the word 'agent' . . . in the contracts themselves", R.III, Plaintiff's Opposition to Defendants' Cross Motion For Summary Judgment, 18.

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[13] The United States suggests that it failed to modify its contracts before 1977 because "the State had previously recognized that the contractors were procurement agents", U.S. Brief, 41, n. 17. As even the United States concedes, it was aware that New Mexico viewed the contractors as taxable as early as 1967, U.S. Brief, 6, eight years before this case commenced. The United States chose to conduct an earlier litigation from 1967 to 1975 without modifying its contracts, but obviously knew that its contractors were at risk, *United States v. Bureau of Revenue*, 87 N.M. 164, 531 P.2d 212 (Ct. App. 1975). The hastily prepared modifications in 1977 did not result from a sudden realization that New Mexico had changed its position but rather from a realization that the United States' case was extremely weak.

These modifications were presumably designed to bring the contracts within the holding of *Kern-Limerick, Inc. v. Scurlock*, 347 U.S. 110, 122-123 (1954) that "the form of contracts, when governmental immunity is not waived by Congress, may determine the effect of state taxation on federal agencies. . .". However, it is one thing to "use the word 'agent' " and another to unreservedly so designate a contractor as contemplated in *Kern-Limerick*. The modifications here are so hedged with qualifications and cautious language that they in no way affect this case.

With slight variations the modifications provide that each contractor "acts as an agent for and on behalf of ERDA for certain purposes", J.A. 50, 55, 59. However, it is conceded that this phrase does not have the effect of "formally and directly designating the contractors as agents for various purposes in the contract modifications," J.A. 64. In fact "[n]o consideration was given by anyone at any time" to such a formal designation, *id.* Similarly, the modifications provide that each contractor "is authorized to pledge the credit of the United States. . .", J.A. 51-52, 56, 60. Again, the United States concedes that "The use of the word 'is' was not intended to imply that these are words of present authorization.", J.A. 64.

This curious drafting resulted in part from AEC's fear that more explicit modifications would "prejudice our case in prior years when such language did not appear" in the contracts, J.A. 62. But in regard to their retroactivity, even AEC officials wondered, ". . .whether execution of the modifications during the course of the litigation really will have the intended effect of convincing the court that the modifications merely 'recognize existing relationships'," R.III, Defendants' Cross-Motion for Summary Judgment, ex. 11. The refusal to affirmatively designate the contractors as agents, the obvious method of compliance with *Kern-Limerick*, also reflects the fear that a victory in New Mexico based on the modifications would expose all

undesignated AEC contractors to taxes in other states. The United States in its brief waivers as to whether the modifications merely "specify" or "characterize" the contractors as agents, U.S. Brief, 5, 32, or affirmatively "designate" them, *id.*, 21, an interpretation which it has already conceded away, J.A. 64.

The conscious refusal to affirmatively designate the contractors as agents renders the modifications a wistful set of arguments as to why advanced funding "establish[es]" an agency relationship, J.A. 50, 55, 59, not a legally operative designation of status.[14] If, for the myriad reasons set out in this brief, advanced funding does not establish an agency relationship, the modifications do not strengthen the United States' contrary assertions; they merely summarize them.

Further nullifying the impact of the modifications is the express provision that they "shall not be construed to modify any other provisions of the contract *nor . . . create rights or obligations not otherwise provided for in the contract*", J.A. 52, 57, 61. This provision was inserted at Sandia's insistence, J.A. 69. It leaves untouched the provisions that all purchase orders shall be made "in the name of Sandia Corporation", J.A. 36-37, and that, in dealing with suppliers, the "Buyer" is "THE ZIA COMPANY", not the United States, J.A. 120. The contractors did not change their purchase orders in any way, Pet. App. 26a, leaving third parties unaware that they are dealing with an "agent". Contrast this omission with the emphatic purchase orders utilized in *Kern-Limerick* and in the sales tax portion of *United States v. Boyd*, 363 S.W.2d at 199.

In the course of negotiating the modifications, Sandia insisted on alteration of an earlier draft so that its employees would not

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[14] It also confirms New Mexico's thesis that AEC has always been extremely reluctant to expressly designate its contractors as agents and has failed to do so here, see pp. 20-23, *supra*.

be specifically designated as "obligees" of ERDA, for fear that this would disrupt its labor relations, J.A. 69-70. So long as the contractors' employees may have no direct claims against the United States, J.A. 197, 200, the contractors' periodic payrolls remain their obligations, not those of the United States.

The power to contract on behalf of ERDA is delegated pursuant to written "management delegations of authority" issuing from the administrator of the agency, R.VI, Carretta depo., 29. Re-delegations are maintained "in writing, locally that is," and "hopefully there were written delegations in the field that got to the name as well as the position", *id.*, 31, 32. It is conceded that the modifications themselves were not formal and direct designations of the contractors to act on behalf of AEC, J.A. 64. There is no evidence of any other written delegation to these contractors. Furthermore, although ERDA's Division of Procurement was advised of the modifications, no official approval of them emanated from that office. Instead, a conscious decision was made that "matters concerning the legal relationships existing between ERDA and its management contractors were matters on which Division of Procurement should defer to the General Counsel, and . . . no response . . . from Division of Procurement was required," R.I, Interrogs. 125-132, 135-136.

ERDA's Albuquerque attorneys decided that they "did not need to ask ERDA Headquarters to 'approve' the modifications", J.A. 77. The General Counsel's office of ERDA in Washington expressed "no objections" to the modifications, R.I, 136, but the modifications themselves did not constitute a present delegation of any powers, J.A. 64. Accordingly, the purported delegation of agency powers to these contractors did not satisfy ERDA's procedures and is invalid.[15] Indeed, AEC tacitly

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[15] It is also unclear whether Congress intended in the Atomic Energy Act of 1946 to authorize delegation of AEC's power to contractually-created agents. Forty-two U.S.C. §2014(a) defines "agency of the United States"

(Cont. p. 34)

concedes that the authority of these contractors to "sign contracts. . . on behalf of ERDA" is not to be found in the procedures granting authority to ERDA's own officials and employees, R.IV, Interrog. 120, Aug. 31, 1976.

If the contractors were not agents before July 1, 1977, the modifications do not change their status. Unless all AEC contractors utilizing advanced funding are automatically federal agents, the modifications in no way support singling out these three contractors.

IV. THE FACT THAT SANDIA CORPORATION PERFORMS ITS CONTRACT WITHOUT RECEIVING A FEE DOES NOT RENDER IT A FEDERAL AGENT.

Zia and LACI are elements of a large conglomerate and receive fees for their work for AEC, R.IV, Interrog. 73, Aug. 31, 1976; J.A. 18, 27. Although Sandia is a for-profit corporation, and a subsidiary of Western Electric Company, its contract specifies

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[15] (Cont. from p. 33)
to include the three branches of government and "any Government agency". In pertinent part, "Government agency" includes "any executive department" and any "independent establishment" or "corporation" which is "wholly or partly owned by the United States of America" and which is "an instrumentality of the United States", 42 U.S.C. §2014(1). The contractors here are concededly not instrumentalities, J.A. 201, and are not wholly or partly owned by the United States, R. IV, Interrog. 8, Aug. 31, 1976. Having specifically defined the criteria of a "Government agency", none of which these contractors satisfy, Congress pre-empted the power to create lesser, contractual, agency relationships. The points at which the term "Government agency" is used in the Act do not shed much light on this issue, see 42 U.S.C. §§2020, 2031, 2064, 2164(d), 2165(c) and 2201(f).

that it receives no fee or profit, J.A. 31. In *United States v. Boyd*, 378 U.S. 39 (1964), this Court distinguished the use tax exemption accorded a no-fee contractor in *United States v. Livingston*, 364 U.S. 281 (1960) (*per curiam*), *aff'g* 179 F.Supp. 9. (E.D.S.C. 1959), based on the "factual determination that du Pont received no benefits from the contract", 378 U.S. at 45, n.6. Following *Boyd*, *Livingston* is relevant to the present case only if a no-fee contract automatically renders Sandia a federal agent. The United States concedes that Sandia does not meet the tests of a federal instrumentality, J.A. 201, and minimizes the impact of *Livingston* as applied to Sandia, U.S. Brief, 22-26.[16] New Mexico concurs, albeit for different reasons. While a no-fee contract might negate the "separable beneficial and taxable use" necessary for use tax liability, *Livingston, supra*, at 22, the same is not true of a tax on receipts relating to a contractor's obligations to its own employees and suppliers.

Du Pont had a much closer relationship with AEC than does Sandia. Du Pont worked "in close collaboration" with, and under the supervision of, two hundred and thirty AEC employees at the site, 179 F.Supp. at 18. Sandia receives little day-to-day supervision from AEC, R.III, Defendants' Cross-Motion, ex. 8, 1. Du Pont actually designed and constructed the plant which it subsequently operated, 179 F.Supp. at 16. Sandia simply stepped in to replace another contractor in a going concern, U.S. Dept. of Energy, *DOE Research & Development & Field Facilities*, June, 1979, IV-112. Du Pont's purchase orders stated that purchases were "for the benefit of the United States Government", 179 F.Supp. at 18. Sandia is required to order in its own

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[16] Since most of its contractors receive fees, the United States is reluctant to read *Livingston's* use tax exemption as hinging on du Pont's no-fee contract. Also, in minimizing *Livingston*, it is hoping to minimize *United States v. Boyd*, which is dispositive of the present case. However, the principles enunciated in *Boyd* transcend the particular tax at issue there.

name and its purchase orders contain no language equivalent to that utilized by du Pont, J.A. 36-37.

Furthermore, unlike du Pont, Sandia and its parent company receive numerous benefits under their contract, making *Livingston* inapplicable. While patents to all discoveries by du Pont belonged to the United States, 179 F.Supp. at 17, Sandia's parent companies receive non-exclusive, irrevocable royalty-free licenses under patents arising from Sandia's work for AEC, J.A. 35. Sandia is affiliated with a parent company that has made over *six billion dollars of profit-making sales* to the United States government between 1966 and 1975, R.IV, Interrog. 44, ex. 2, June 22, 1977.[17] Sandia's profit-making parent is further benefited because the salaries of some of its employees are borne by Sandia, subject to reimbursement under its contract with AEC. For example, these salaries totalled $312,000 in 1975, R.IV, Interrog. 40, Aug. 31, 1976. The parent is also paid by Sandia for audit services and other supervision, again subject to reimbursement from AEC under the contract, J.A. 40-42.

While the district court in *Livingston* minimized du Pont's non-monetary benefits, 179 F.Supp. at 23, there are business advantages for AEC contractors more valuable than any fees:

> The acquisition of invaluable technical and engineering information and experience; the establishment of a reputation as a pioneer in an incalculably great industrial field; the opportunity to gain a march on future competitors (perhaps the opportunity to enjoy an at least temporary monopoly); the possibility of acquiring

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[17] Western Electric is a party to the contract with Sandia and the United States here, R. II, Plaintiff's Motion For Summary Judgment, ex. 3 to Roser Affidavit, 45.

> valuable patents as an outgrowth of research and development activities conducted at federal expense.
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> Newman, *The Atomic Energy Industry: An Experiment in Hybridization*, 60 Yale L.J. 1263, 1320 (1951).

In *Livingston*, the court concluded that du Pont entered its contract "without hope of gain" and out of a "high sense of public responsibility" and acted as the "alter ego" of the Atomic Energy Commission, 179 F.Supp. at 18, 23. This Court's affirmation of these conclusions must certainly have been bolstered by a remarkable stipulation by the State of South Carolina, which is quoted at page 19 of the Motion to Affirm before this Court in that case:

> Each and every operation carried on by du Pont in the procurement and physical use of the material here involved was solely on behalf of the United States. Du Pont did not, as a matter of fact exercise any separate interest in the property involved. Its procurements were solely on behalf of the United States. Its physical use of the property owned by the United States was to accomplish the aims of the United States. At no time did du Pont have the beneficial use of such property for its private ends.

No equivalent stipulation will be found in the present case. The fact that this Court affirmed the three-judge decision solely on a Motion to Affirm, without briefs and oral arguments, weakens the vitality of *Livingston* as a precedent applicable to Sandia. An affirmance without opinion does not carry the precedential weight of an opinion on the merits, *Tully v. Griffin*, 429 U.S. 69 (1976).

Current regulations lay down the circumstances in which some management contractors will receive fees and others will not. What may have been determined by a contractor's "high sense of public responsibility" twenty years ago, *United States*

v. Livingston, 179 F.Supp. 9, 23 (1959), is now routinized by regulation.

Basically "[t]he determination of a fair and reasonable profit or fee is a matter of sound business judgment", J.A. 209. For example, it is ERDA policy "not to pay fees under contracts with educational institutions", J.A. 212. On the other hand, "[i]t is general ERDA policy to pay fees in contracts with not-for-profit organizations; however, *it is a matter of negotiation whether a fee will be paid in a given case*", J.A. 211, emphasis added.

The determination of whether a not-for-profit organization [which Sandia is not] receives a fee is not determined by its degree of patriotism. Instead, "[i]n computing the amount of fee to be paid, take into account *the tax posture* of the not-for-profit organization," J.A. 212, para. (c), emphasis added.

No-fee contracts are not unique to the Atomic Energy Commission. Approximately 2% of all military procurements by the Department of Defense are also on a no-fee basis, Department of Defense, *Military Prime Contract Awards: Fiscal Year 1979*, April 30, 1980, 78. It is unlikely that the Atomic Energy Commission's regulations were intended to identify some contractors as no-fee agents and some as independent contractors purely on the basis of the fees they receive.[18]

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[18] There are "above the line" benefits even when no fee is received. At the time that du Pont operated the South Carolina facility, the General Electric Company operated AEC's Hanford facility for a fee of $1.00 a year. The then-Chairman of the Atomic Energy Commission recorded that General Electric didn't "want to get tarred with the . . . 'merchants of death' . . . brush, don't [sic] want to make profit out of it", Lilienthal, *The Journals of David E. Lilienthal*, Vol. II, Harper & Rowe, New York, 1964, 607. However, General Electric also received a payment for "factory overhead" ranging from 119% to 143% of direct labor costs and "administrative overhead" of $200,000 per month. This prompted a congressional investigation amid complaints that the dollar-a-year fee was deceptive, *Hearings before*

(Cont. p. 39)

The New Mexico tax is, as its name indicates, a tax on a contractor's gross receipts. It is levied regardless of whether the contractor makes a profit, loses money or breaks even, *New Mexico Enterprises, Inc. v. Bureau of Revenue*, 86 N.M. 799, 528 P.2d 212 (Ct.App. 1974). Unless an entity has a 501(c)(3) exemption, which Sandia does not, it must pay tax on its total gross receipts.

V. ABSENT EXPLICIT AUTHORIZATION BY THE UNITED STATES CONGRESS, EXECUTIVE BRANCH PERSONNEL MAY NOT INSULATE PRIVATE CONTRACTORS FROM STATE TAXES BY DESIGNATING THEM AS AGENTS.

In *James v. Dravo Contracting Company*, 302 U.S. 134 (1937), this Court swept away over a century of caselaw stringently limiting the states' power to tax private entities even remotely connected with the federal government,[19] and approved

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[18] (Cont. from p. 38)
the Sub-Committee of the Committee on Appropriations, U.S. Sen., on Independent Offices Bill for 1950, 81st Cong., 1st Sess., 1271 *et seq.*, May 11, 1949. Certainly the *Livingston* court would never have viewed the General Electric Company as a tax free agent, based on its "high sense of public responsibility", 179 F.Supp. 9, 23 (1959). While Sandia's parent company receives certain overhead payments, they do not rival those received by General Electric. Nevertheless, the General Electric experience demonstrates that a contractor's tax immunity should not hinge on a judicial determination of patriotic or charitable motives in not accepting a fee.

[19] Examples are decisions forbidding gross receipts taxes on government contractors, *Panhandle Oil Co. v. Mississippi ex rel. Knox*, 277 U.S. 218 (1928); income taxes on the wages of federal employees, *Dobbins v. Commissioners of Erie County*, 41 U.S. (16 Pet.) 435 (1842); and taxes on the profits derived from exploitation of oil and gas leases on Indian lands, *Gillespie v. Oklahoma*, 257 U.S. 501 (1922).

application of state taxes so long as they were non-discriminatory and so long as their legal incidence did not touch the United States. This Court dealt with high principles in *James v. Dravo,* principles defining the constitutional boundaries of the competitive relationship among federal and state governments in the all-important field of taxation. To those who administer these governments, faced with either the threat of new liabilities or the promise of new revenues, the issue may not have been so much high principles as the prospect of large sums ultimately to be derived from each other's treasuries.

The constitutional distinction between taxes falling directly on the federal government and taxes falling on its contractors exposed the United States to the newly-imposed burden of its contractors' taxes in some states. In such states, officials of the Executive Branch now sought ways to shift the legal incidence to the United States *contractually,* unilaterally conferring immunity on its contractors. The primary strategy has been to assert that a contractor is an agent of the federal government, insulating its purchases and expenditures from state taxes. The agency contention is sometimes based on selectively inserted clauses designating a contractor as an agent; in other cases, the overall relationship is asserted to prove agency in the absence of formal recognition of the status.

This practice, potentially vitiating *James v. Dravo Contracting Company,* was approved in regard to dealings with suppliers in *Kern-Limerick, Inc. v. Scurlock,* 347 U.S. 110 (1954). There, this Court held that statutory authority to negotiate contracts "of any type which . . . will promote the best interests of the Government" authorized the drafting of contracts and purchase orders which designated a private contractor as an agent, thereby insulating the contractor from state taxes, 347 U.S. 114, 116. Noting the similarities of operation between the contractor in *Kern-Limerick* and the contractor held taxable in *Alabama v. King & Boozer,* 314 U.S. 1 (1941), this Court stated that "the

form of contracts, when governmental immunity is not waived by Congress, may determine the effect of state taxation on federal agencies . . .", at 122-123.

The Executive Branch agencies enter into thousands of contracts with private contractors every year. Having interpreted the statutory power to contract as Congressional permission to insulate contractors from state taxes, the *Kern-Limerick* decision has placed the balance of federal-state tax relations completely in the hands of Executive Branch contracting officials, numbering in the thousands.[20] While the Atomic Energy Commission has neglected for policy reasons to avail itself of *Kern-Limerick's* shelter in the present case, *Kern-Limerick* extends the promise that the AEC's relations with its contractors may ultimately be structured to escape state taxes.

Kern-Limerick stands as an anomaly in resolving momentous federal-state issues on the basis of chance contract clauses. As recently as July of 1981, this Court took a far different position in a commerce clause context, approving a lower court observation that, "[i]t would be strange indeed if the legality of a tax could be made to depend on the vagaries of the terms of contracts", *Commonwealth Edison Co. v. Montana*, 49 U.S.L.W. 4957, 4960, n.8 (1981). This echoed Justice Douglas' dissent in *Kern-Limerick:*

> The concepts "title," "agency," and "obligation to pay" are no basis for this constitutional adjudication. Today they are used to permit any government functionary to draw the constitutional line by changing a few words in a contract . . . We should hold that, until the Congress says differently, the States are free to tax all sales to cost-plus government contractors.
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> 347 U.S. at 126-127 (1954) (Douglas, J., dissenting).

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[20] There are 5,000 contracting officers in the Department of Defense alone, Pace, *Negotiation and Management of Defense Contracts*, John Wiley & Sons, 1970, 19.

Indeed, this Court adopted Justice Douglas' formulation, in a slightly different context, in one of the three Michigan "property cases" decided four years later. There, the Court refused to look to the formalities of the contract between the United States and the contractor to determine whether the latter was immune: "Constitutional immunity from state taxation does not rest on such insubstantial formalities as whether the party using government property is formally designated a "lessee". *Otherwise immunity could be conferred by a simple stroke of the draftsman's pen." United States v. Township of Muskegon,* 355 U.S. 484, 486 (1958), emphasis added.[21]

In *Kern-Limerick* this Court held that, once the Executive Branch had unilaterally assimilated a private entity into the government, it was for Congress to "waive" that immunity, 347 U.S. at 122-123. Generally, this Court has taken a different approach: that it is for Congress to *grant* immunity to private entities.[22] In *City of Detroit v. Murray Corporation,* 355 U.S.

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[21] Even in the *Kern-Limerick* decision itself, this Court acknowledged precedents holding that "One acting as a private agent may be bound, notwithstanding his known agency, upon contracts which he executes in his own name", *United States Shipping Board Merchant Fleet Corp. v. Harwood,* 281 U.S. 519, 524 (1929), cited at 347 U.S. 121, n. 10. In that latter case, this Court held that precisely because the contractor was a corporation and because all its money came from the United States, "[t]here is thus no basis for presuming that the Fleet Corporation is not to be deemed bound by the contracts into which it enters merely because it is acting as such an agency. . .", *id.*, at 525.

[22] *Kern-Limerick* is also anomalous in its departure from the doctrine that, "the silence of Congress, when it has authority to speak, may sometimes give rise to an implication as to the Congressional purpose. . . But there is little scope for the application of that doctrine to the tax immunity of governmental instrumentalities," *Graves v. New York,* 306 U.S. 466, 479-480 (1939). Thus, "Silence of Congress implies immunity no more than does the silence of the Constitution," *id.*, 480. Similarly, in refusing to find a Congressional intent to exempt personal property of Indians

(Cont. p. 43)

489 (1958), this Court stated that, ". . . the Congress is the proper agency . . . to make the difficult policy decisions necessarily involved in determining whether and to what extent private parties who do business with the Government should be given immunity from state taxes." Similarly, in holding that two AEC contractors were neither federal agents nor instrumentalities, this Court stated, ". . . it is for Congress, in the valid exercise of its proper powers. . ." to grant state tax immunity if it chose, *United States v. Boyd*, 378 U.S. 39, 51 (1964). Again, in affirming *Livingston v. United States*, 179 F.Supp. 9 (1960), this Court implicitly approved dictum that "It is frequently said that Congress has the power to extend the immunity of the United States beyond the constitutional limits, *but a contracting officer has no such power. . .*", at 20, emphasis added.

Following the *Kern-Limerick* decision, legislation to reverse its impact was promptly introduced.[23] Although none of the bills passed, they achieved their intended purpose when the Department of Defense, the chief beneficiary of the *Kern-Limerick* decision, promised Congress "that it will be the policy of the Department of Defense not to designate prime contractors on cost-type contracts to be performed within the continental limits of the United States, as agents of the Government

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[22] (Cont. from p. 42)
from the Oklahoma estate tax, it was held that, "[t]his Court has repeatedly said that tax exemptions are not granted by implication . . . If Congress intends to prevent the State of Oklahoma from levying a general non-discriminatory estate tax applying alike to all its citizens, *it should say so in plain words.* Such a conclusion cannot rest on dubious inferences." *Oklahoma Tax Commission v. United States*, 319 U.S. 598, 606-607 (1943), emphasis added.

[23] These included H.R. 7206/S.2100, 84th Cong., 1st Sess. (1955); S.6, 85th Cong., 1st Sess. (1957); and H.R. 6057, 87th Cong., 1st Sess. (1961). S.6 was passed by the Senate on March 4, 1958.

for the purchase of supplies", Jan. 28, 1955, Letter from Deputy Assistant Secretary of Defense to Director, Bureau of Budget; J.A. 214; *Hearings Before a Subcomm. of the Comm. on Gov't Operations, 85th Cong., 1st Sess., on S.6,* June 11-12, 1957, 75: These developments suggest that this Court may have misread Congress' intent to empower the Executive Branch to insulate its contractors from state taxes.

There is a disturbing twist to the enactment of this Defense Department policy which illustrates the dangers of relying on the Executive Branch to fairly maintain the balance between state and federal interests. Although it had promised Congress not to insert agency-creating clauses, the Defense Department continued to argue in case after case that its contractors *were* agents, *Boeing Company v. Omdahl,* 169 N.W.2d 696 (N.D. 1969); *State ex rel. Thompson-Stearns-Roger v. Schaffner,* 489 S.W.2d 207 (Mo. 1973); *Day & Zimmerman, Inc. v. Calvert,* 519 S.W.2d 106 (Texas 1974), *cert. denied,* 423 U.S. 832 (1976); *United States v. New Mexico,* 581 F.2d 803 (10th Cir. 1978).[24]

While the Atomic Energy Commission has not been as aggressive as the Department of Defense, the self-conscious attempts by AEC attorneys in drafting the 1977 modifications to come within *Kern-Limerick* while preserving every possible advantage of non-agent status, J.A. 62-80, and the almost comic machinations of the AEC attorney who, in 1968, inserted clauses in

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[24] After the Defense Department's policy and conflicting practice came to light in the cited New Mexico case, the Department "reiterated its 1955 policy statement not to designate cost contractors as agents", agreed that general contract clauses "lend little support for contending that contractors are agents", and agreed that, in future, alternative clauses and practices would be devised to accomplish their "nontax purposes" without providing a basis for an agency contention, Friedman, *The State Tax Liability of Federal Contractors,* Revenue Administration, 1977, Natl. Assn. of Tax Administrators, Wash., D.C., 1977, 65, 72.

the Zia contract expressly denying any agency status in the mistaken belief that it would still be immunized by other clauses, R.IV, Interrog. 11, Feb. 7, 1977; R.V, ex. 17-A, illustrate the inevitable consequences when determinations in this area are left to those most responsible for their budgetary impact.

At least two commentators have criticized the *Kern-Limerick* rationale, see Tribe, *Intergovernmental Immunities in Litigation, Taxation, and Regulation: Separation of Powers Issues in Controversies About Federalism*, 89 Harv. L.R. 682 (1976); Mahoney, *Federal Immunity From State Taxation: A Reassessment*, 45 U.Chi.L.R. 695 (1978). Professor Tribe questions why the United States should ". . . ever be allowed to cut off state revenue sources without congressional action – a power denied the executive when it assumes the economic burden of a tax but neglects the incantation of that magic language," 89 Harv. L.R. at 710.

Because the actions by federal contracting officers in inserting agency-creating clauses occur sporadically and only in those states where taxation is threatened, they are not subject to systematic scrutiny by either the Executive Branch or Congress. Congress alone is in a position to review the varying tax structures of all the states and the federal government.

In *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819), this Court recognized that its blanket prohibition of state taxation of federal activities might "not extend to a tax paid by the real property of the bank, in common with the other real property within the State, nor to a tax imposed on the interest which the citizens of Maryland may hold in this institution, in common with other property of the same description throughout the State", *id.*, at 436. While the Marshall court repudiated its own dictum in *Weston v. City Council*, 27 U.S. (2 Pet.) 449, 468-469 (1829), against a strong dissent, *id.*, at 472-473 (Johnson, J.,

dissenting), the theme that only discriminatory state taxation of federal operations is prohibited under the constitution has endured. In *United States v. County of Fresno*, 429 U.S. 452 (1977), this Court read the above quote from *M'Culloch* with a non-discrimination gloss, 429 U.S. at 459, noting that

> [f]or many years the Court read the decision in M'Culloch as forbidding taxes on those who had contractual relationships with the Federal Government . . . In later years, however, the Court departed from this interpretation of M'Culloch,
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> *Id.*, at 460.

Thus, this Court has come close to adopting the observation that

> One could, and perhaps should, read M'Culloch . . . simply for the principle that the Constitution prohibits a state from taxing discriminatorily a federally established instrumentality,
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> *First Agricultural National Bank v. State Tax Commission*, 392 U.S. 339, 350 (1968) (Marshall, J., dissenting).

The case for approving non-discriminatory taxation of private entities related to the United States only through contracts is far stronger. New Mexico urges that this Court reconsider its holding in *Kern-Limerick*, as either a misreading of Congressional intent or as an unwarranted restriction on the power of the states to levy non-discriminatory taxes whose legal incidence falls on private contractors, not on the United States.

CONCLUSION

The judgment of the court of appeals should be affirmed.

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September, 1981

APPENDIX A – N.M. Stat. Ann. 1953

§72-16A-2. **Purpose.**–The purpose of the Gross Receipts and Compensating Tax Act is to provide revenue for public purposes by levying a tax on the privilege of engaging in certain activities within New Mexico and to protect New Mexico businessmen from the unfair competition that would otherwise result from the importation into the state of property without payment of a similar tax.

§72-16A-3(K). [(as amended) (Supp. 1978)] "service" means all activities engaged in for other persons for a consideration, which activities involve predominantly the performance of a service as distinguished from selling property. In determining what is a service, the intended use, principal objective or ultimate objective of the contracting parties shall not be controlling.

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§72-16A-12.17. **Exemption; gross receipts tax; certain organizations.**–Exempted from the gross receipts tax are the receipts of organizations that demonstrate to the bureau that they have been granted exemption from the federal income tax by the United States commissioner of internal revenue as organizations described in Section 501(c)(3) of the United States Internal Revenue Code of 1954, as amended or renumbered. This section does not apply to receipts derived from an unrelated trade or business as defined in Section 513 of the United States Internal Revenue Code of 1954, as amended or renumbered.

§72-16A-14.9. [(as amended) (Supp. 1978)] **Deduction; gross receipts tax; sales to governmental agencies.**–Receipts from selling tangible personal property, other than nonfissionable metalliferous mineral ore, to the United States or any agency or instrumentality thereof or the state of New Mexico or any political subdivision thereof may be deducted from gross receipts. Receipts from selling tangible personal property, other

than nonfissionable metalliferous mineral ore, to the governing body of an Indian tribe or Indian pueblo for use on Indian reservations or pueblo grants may be deducted from gross receipts. That portion of the receipts from performing a service as defined in Subsection K of Section 7-9-3 [§72-16A-3] NMSA 1978 which reflects the value of tangible personal property utilized or produced in performance of such service is not deductible.

APPENDIX B – 41 U.S.C. §255

Advance or other payments; restrictions; conditions

(a) Any executive agency may–

(1) make advance, partial, progress or other payments under contracts for property or services made by the agency; and

(2) insert in bid solicitations for procurement of property or services a provision limiting to small business concerns advance or progress payments.

(b) Payments made under subsection (a) of this section may not exceed the unpaid contract price.

(c) Advance payments under subsection (a) of this section may be made only upon adequate security and a determination by the agency head that to do so would be in the public interest. Such security may be in the form of a lien in favor of the Government on the property contracted for, on the balance in an account in which such payments are deposited, and on such of the property acquired for performance of the contract as the parties may agree. This lien shall be paramount to all other liens.

APPENDIX C – Section 4(c)(2) of the Atomic Energy Act of 1946, 60 Stat. 759, now codified at 42 U.S.C. § 2061(b)

OPERATION OF THE COMMISSION'S PRODUCTION FACILITIES.– The Commission is authorized and directed to produce or to provide for the production of fissionable material in its own facilities. To the extent deemed necessary, the Commission is authorized to make, or to continue in effect, contracts with persons obligating them to produce fissionable material in facilities owned by the Commission. The Commission is also authorized to enter into research and development contracts authorizing the contractor to produce fissionable material in facilities owned by the Commission to the extent that the production of such fissionable material may be incident to the conduct of research and development activities under such contracts. Any contract entered into under this section shall contain provisions (A) prohibiting the contractor with the Commission from subcontracting any part of the work he is obligated to perform under the contract, except as authorized by the Commission, and (B) obligating the contractor to make such reports to the Commission as it may deem appropriate with respect to his activities under the contract, to submit to frequent inspection by employees of the Commission of all such activities, and to comply with all safety and security regulations which may be prescribed by the Commission. Any contract made under the provisions of this paragraph may be made without regard to the provisions of section 3709 of the Revised Statutes (U.S.C., title 41, sec. 5) upon certification by the Commission that such action is necessary in the interest of the common defense and security, or upon a showing that advertising is not reasonably practicable, and partial and advance payments may be made under such contracts. The President shall determine at least once each year the quantities of fissionable material to be produced under this paragraph.

APPENDIX D – 31 C.F.R. Part 205 (1976)

PART 205–WITHDRAWAL OF CASH FROM THE TREASURY FOR ADVANCES UNDER FEDERAL GRANT AND OTHER PROGRAMS

Sec.

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AUTHORITY: 5 U.S.C. 301 and sec. 203, 82 Stat. 1101, 42 U.S.C. 4213.

SOURCE: The provisions of this part contained in Department Circular 1075, 3d Revision, 38 F.R. 5242, Feb. 27, 1973, unless otherwise noted.

§ 205.1 Purpose.

Federal grant and other programs involving advances to various organizations outside the Federal Government constitute a significant portion of the Federal budget. Advances of cash from the Treasury to such organizations (thereinafter called recipient organizations) for the purpose of financing their current operations under the Federal programs have a substantial impact on Treasury financing costs and the level of the public debt. The purpose of this part is to prescribe the timing of such advances and the procedures to be observed to assure that cash withdrawals from the Treasury occur only when

essential to meet the needs of a recipient organization for its actual disbursements.

§ 205.2 Scope of regulations.

(a) The regulations in this part cover disbursement practices for all cash advances to recipient organizations (including States and local governments, educational institutions, international organizations, and any other public and private organizations) under Federal grant or other programs. The regulations also establish guidelines to be observed by Federal program agencies with respect to their responsibilities in executing grant and other programs, including their review of recipient organization practices in obtaining cash advances by drawing on letters of credit and otherwise. Coverage applies to any Federal program requiring advances to finance the recipient organization's activities in carrying out the program, whether by contract, grant, contribution, or other form of agreement. (Advance payments on procurement contracts are also subject to the provisions of the Federal Procurement Regulations regarding contract financing which appear at 41 CFR Part 1-30 and the provisions of the Armed Services Procurement Regulations regarding defense contracting which appear at 32 CFR Part 163.) Although the regulations of this part are not generally applicable to loan programs, the letter-of-credit method described in § 205.5 should be considered by program agencies for application to loans carrying interest rates which are lower than Treasury borrowing rates.

(b) These regulations are not intended to apply to Government disbursements made to reimburse an organization for work already performed and financed with the organization's own working capital. However, these regulations do apply to reimbursable grant programs involving nonprofit organizations participating in the single letter-of-credit funding system as outlined in § 205.8. Any other specific application of features of these

regulations to reimbursement payments will be considered by the Department of the Treasury if requested by a program agency.

§ 205.3 General policy.

Regardless of the particular method used, advances to a recipient organization shall be limited to the minimum amounts needed and shall be timed to be in accord only with the actual, immediate cash requirements of the recipient organization in carrying out the purpose of the approved program or project. The timing and amount of cash advances shall be as close as is administratively feasible to the actual disbursements by the recipient organization for direct program costs and the proportionate share of any allowable indirect costs.

§ 205.4 Treasury check.

When the annual advance to a recipient organization is less than $250,000 or if the annual advance to a recipient organization aggregates more than $250,000 but there is not a continuing relationship for at least 1 year, the advance shall ordinarily be made by Treasury check. Advances by Treasury check shall be made only in amounts necessary to meet current disbursement needs. Program agencies shall schedule advances made by Treasury check so that the funds are available to the recipient organization only immediately prior to their disbursement by the organization. Therefore, if disbursements are made by the recipient organization on a monthly, biweekly, or any other regular cycle, and the amounts involved would so warrant, the issuance of Treasury checks shall be similarly timed.

§ 205.5 Letter of credit.

(a) If a program agency has, or expects to have a continuing relationship with a recipient organization for at least 1 year, involving annual advances aggregating at least $250,000, the agency shall use the letter-of-credit method.

(b) This method provides program agencies, recipient organizations, and the Department of the Treasury with mechanics specifically designed to enable a recipient organization to obtain cash from Treasury promptly and with such frequency as may be necessary based upon its own determination of when and how much is actually needed for its disbursements.

(c) A letter of credit, which must be executed by an authorized certifying officer of the program agency concerned, gives the recipient organization the authority to draw directly on the Treasury, through its commercial bank (acting as its agent) and either a Federal Reserve Bank (acting as agent of the Treasury) or the Division of Cash Services, Bureau of Government Financial Operations, subject to any monetary and other limits established by the program agency. Withdrawals must be made by authorized officials of the recipient organization designated by it and approved by the program agency's certifying officer.

(d) A letter of credit is irrevocable (the equivalent of cash available to the recipient organization) to the extent the recipient organization has obligated funds in good faith thereunder in executing the authorized Federal program in accordance with the grant, contract, or other agreement.

(e) Use of letters of credit shall be covered by a clause in the grant, contract, or other financing agreement whereby the recipient organization commits itself to (1) the practice of initiating cash drawdowns only when actually needed for its disbursements, (2) the timely reporting of cash disbursements and balances as required by the program agency, and (3) the imposition of the same standards of timing and amount upon any secondary recipients including the furnishing of reports of cash disbursements and balances, with the understanding that failure to adhere to these provisions may cause the unobligated portion of the letter of credit to be revoked by the program agency or by the Department of the Treasury. The financial management system of the recipient organization shall provide

for effective control over and accountability for all Federal funds. With respect to State and local governments, this is stated in OMB Circular A-102.

(f) Drawdowns shall not ordinarily be made more frequently than daily, or be in amounts less than $10,000 or more than $1 million, but in no case more than $5 million unless so stated on the letter of credit.

(g) Since the letter-of-credit method enables the recipient organization to withdraw cash from the Treasury concurrently with and as frequently as disbursements are made by the recipient, there need be no time lag between drawdowns from the Treasury and disbursements by the recipient organization. Therefore, there is no necessity for the recipient organization to maintain balances of Federal cash other than the small balances necessary to accommodate the minimum limitation on individual drawdowns as provided for in paragraph (f) of this section and to provide for an element of bank float.

(h) In general, agreements shall provide for a recipient organization to initiate each drawdown at approximately the same time that checks are issued by the organization in payment of program liabilities, including those for allowable indirect costs, and in an amount approximately equal to the Federal share of such payments. In order to take advantage of the float on checks outstanding, program agencies wherever possible should arrange for recipient organizations to delay drawdowns on letters of credit until after the checks issued for program disbursements have been forwarded to the payees.

(i) In specific instances, as determined mutually by the Department of the Treasury and the program agency, a recipient organization may be requested to authorize its commercial bank to draw on a letter of credit in its behalf when checks issued by the recipient organization (covering disbursements of Federal funds) are presented to the bank for payment.

§ 205.6 Secondary recipients.

(a) Advances made by primary recipient organizations (those which receive payments directly from the Federal Government) to secondary recipients shall conform substantially to the same standards of timing and amount as apply to advances by Federal agencies to primary recipient organizations.

(b) Federal program agencies should encourage primary recipient organizations to develop procedures, similar to the Federal letter of credit, whereby secondary recipients can draw on the primary recipient as funds are needed for disbursement, in lieu of the primary organization advancing funds to the secondary recipient organization.

§ 205.7 Termination of advance methods of financing grant programs.

(a) When a recipient organization receiving advances by a letter of credit or by Treasury check has demonstrated to a program agency an unwillingness or inability to establish procedures that will minimize the time elapsing between advances and the disbursement thereof, the program agency, if permitted by the statutes governing the grant(s) in question, shall require the recipient organization to finance its operations with its own working capital, and payments to the recipient organization shall be made by Treasury check to reimburse it for actual cash disbursements. Program agencies shall process such reimbursements expeditiously so as to minimize the time elapsing between disbursement by and payment to the recipient organization.

(b) In those cases when the reimbursement method described in paragraph (a) of this section is not feasible, arrangements may be made whereby the operations of the recipient organization are financed on a working capital advance basis. On this basis, funds may be advanced to the recipient organization to cover its estimated disbursement needs for a given initial period. Thereafter, the recipient organization would be reimbursed for

the amount of its actual cash disbursements. The amount of the initial advance shall be geared to the reimbursement cycle so that after the initial period the advance approximately equals the average amount of the recipient organization's unreimbursed program payments.

§ 205.8 Single letter of credit.

(a) The single letter of credit is basically the replacement of numerous letters of credit held by a recipient organization with one letter of credit administered centrally. It provides the mechanics for a single flow of funds between the Federal Government and the particular recipient organization.

(b) Each Federal program agency should work toward the objective of establishing a single letter of credit with each State government. As a first step, each program agency should consolidate its own internal procedures to provide for a single letter of credit being issued to each State to fund all the programs of that Federal agency as a whole. In addition, each program agency should join with the Department of the Treasury in efforts to achieve a single letter of credit from the Federal Government as a whole to each of the States.

(c) When a single letter of credit is established with a State, Federal program agencies may include in the single letter of credit, subject to the provisions of paragraph (d) of this section, reimbursable grant programs and also smaller grant programs which do not meet the $250,000 yearly limitation otherwise required in the use of letters of credit.

(d) The implementation of a single letter of credit with a State shall first be approved by Treasury and must be covered by a written agreement whereby the State obligates itself to the provisions outlined in § 205.5(e). The agreement must also indicate that the Department of the Treasury reserves the right to revoke the letter of credit in the event of noncompliance with any of these provisions.

(e) If requested by a program agency, the Department of the Treasury will consider application of the single letter of credit to include recipient organizations other than State governments.

(f) The single letter of credit is a significant step in the simplification of Federal grant-in-aid funding and provides for a more effective means of administering the letter-of-credit method of funding grant-in-aid programs. The single letter of credit, as designed, will minimize the cash flow from Treasury with substantial savings and will facilitate sound cash management principles on the part of the recipient organizations.

§ 205.9 Responsibility of program agencies.

Regardless of the particular method used to advance funds, the program agency is responsible for (a) making such reviews of the financial practices of recipient organizations, both primary and secondary, as are necessary to insure that the provisions of this Part 205 are being complied with, and (b) instituting such remedial measures as may be necessary in the event that a recipient organization demonstrates its unwillingness or inability to comply with these provisions. Implementing procedures of program agencies shall specify the methods employed to carry out these responsibilities. Also, each program agency shall furnish the Department of the Treasury with reports, semiannually, showing cash balances in the hands of the recipient organizations as of each June 30 and December 31.

§ 205.10 Implementing instructions.

Implementing procedural requirements under this part will be promulgated by the Commissioner of the Bureau of Government Financial Operations in the Treasury Fiscal Requirements Manual for Guidance of Departments and Agencies.

§ 205.11 Waivers.

Any waivers of provisions of this part previously granted to program agencies are hereby revoked. Requests for waivers of

specific provisions of this part shall be presented in writing to the Commissioner of the Bureau of Government Financial Operations.